Request No. DTE 3-1

Please refer to the Company's response to Information Request DTE-1, part (d).

(a) Do prepaid pension balances arise when contributions to the pension plan exceed SFAS No. 87 pension expense? Conversely, do prepaid pension balances reverse when SFAS No. 87 pension expense exceeds plan contributions?

(b) Do pension liabilities arise when SFAS 87 pension expense exceeds contributions to the pension plan? Do pension liabilities reverse when contributions to the pension plan exceed SFAS 87 pension expense?

(c) Given that Unitil Energy Systems and Fitchburg customers provided the funds which gave rise to the prepaid pension balances, please explain the rationale for transferring those balances to the Service Company. Discuss whether it would be appropriate to use the prepaid balances supplied by utility customers for the sole purpose of reducing future contributions attributable to remaining utility employees.

(d) Since the Service Company has a pension liability without any transfer of prepaid pension balances, can it be inferred that the pension liability would exist with or without the transferred employees? Is it the Company's position that the Service Company pension liability is attributable to the transferred employees only?

(e) Given that there is one defined benefit plan for Unitil Corporation, why do utility contributions to the pension plan exceed SFAS 87 pension expense, while the Service Company's SFAS 87 expense exceeds contributions?

Response:

a) Yes. Prepaid pension balances do arise when contributions to the pension plan exceed SFAS No. 87 ('FAS 87") pension expense and, conversely, prepaid pension balances are reduced, or a liability is recognized, when FAS 87 pension expense exceeds plan contributions. These facts demonstrate the relationship of pension contributions to book expense.

In addition, prepaid pension amounts are recognized, or arise, when the calculation of FAS 87 pension expense for a period is actually pension <u>income</u> rather than expense. In this case, the prepaid pension balances recognized are not directly related to cash contributions made or not made in the current period.

Over the horizon of the pension's actuarial calculations, it is assumed that prepaid pension amounts are impacted by actual cash contributions. However, "required" cash contributions are calculated each period by taking into account the Plan's funded status and its Funded Standard Account in accordance with the Employees Retirement Income Security Act ("ERISA') rules. Therefore there is actually an indirect, versus a direct, correlation between prepaid pension assets recognized when FAS 87 expense for the period is actually <u>income</u>. In contrast, there is a direct correlation between contributions and prepaid pension assets when contributions are higher or lower than FAS 87 expense for the period.

b) Yes. Pension liabilities do arise when FAS 87 pension expense exceeds contributions to the pension plan and, conversely, pension liabilities are reduced, or an asset is recognized, when contributions to the pension plan exceed FAS 87 pension expense.

In addition, pension liabilities are reduced when the calculation of FAS 87 pension expense for a period is actually pension <u>income</u> rather than expense. In this case, the reduction of pension liability balances is not directly related to cash contributions made or not made in the current period.

Over the horizon of the pension's actuarial calculations, it is assumed that pension liability amounts are impacted by actual cash contributions.

However, "required" cash contributions are calculated each period by taking into account the Plan's funded status and its Funded Standard Account in accordance with the ERISA rules. Therefore there is actually an indirect, versus a direct, correlation between pension liabilities recognized when FAS 87 expense for the period is actually income. In contrast, there is a direct correlation between contributions and pension liabilities when contributions are higher or lower than FAS 87 expense for the period.

c) As discussed in the responses to DTE 1-1 and DTE 2-2, "there are no plans to apply the FG&E's Prepaid Pension (there are no Prepaid PBOP assets) assets against the liabilities of other [Unitil] plan participants" and therefore there has been no discussion of a rationale for transferring those balances to the Service Company.

As discussed in a) above, the prepaid balances recognized by FG&E (since the adoption of FAS 87 in 1987) have arisen over time due to two types of events: Type 1) periods when pension contributions exceeded FAS 87 expense, and Type 2) periods when FAS 87 expense was actually income and prepaid assets were recognized for book accounting purposes.

On balance, it would be appropriate to use the prepaid balances related to contributions (Type 1) collected from customers for the purpose of reducing future contributions attributable to employees who provide services to the utility. Certain of those employees have remained with the utility and others are employed at the Service Company. The utility receives vital services from the Service Company, including a 7-24 customer service function [ref. DTE 1-1 Response], and certain of the Service Company employees have transferred from the utility to the Service Company. The Service Company provides services to the utility at cost with no mark-up or profit margin.

In principle, it would be appropriate to use the prepaid balances related to pension income book accounting (Type 2) on a reconciling basis over the life of the pension plan as the actuarial calculations of annual FAS 87 expense amortize the plan's gains and losses over the long term horizon of the plan's obligations.

d) The Service Company was formed in 1984 with an initial core group of 14 employees to provide centralized administrative and management services. Since then the Service Company has grown to provide a multitude of vital and integral services to Unitil's operating utilities. The Service Company now has over 160 employees who have transferred to the Service Company from the operating utilities or have been hired by the Service Company over the years to serve the operating utilities. The Service Company exists for the sole purpose of providing vital services to the operating utilities which it does at cost.

It would not be fair to infer that a pension liability would exist at the Service Company with or without the transferred employees. If the Service Company did not exist, the pension liability would have been recognized on the utility's books over time.

It is not the Company's position that the Service Company pension liability is attributable to the transferred employees only. The Service Company workforce has evolved over time. It is the Company's position that the Service Company pension liability is attributable to employees who are integral to the vital and cost effective services provided to the operating utilities.

e) As discussed in Response to DTE 1-1 (a), (b) and (c) and shown in Exhibit DTE 1-1-C; contributions to the pension plan are allocated to each company participating in the plan on a pro-rata basis based on each participating company's proportionate share of FAS 87 expense for the period as determined by the Company's actuaries.

In practice, a certain amount of FAS 87 pension expense is charged to construction overheads at the operating utilities each period. As shown in Exhibit DTE 1-1-C, in 2004 the pension contribution amount was $2,000,000 in total and the FAS 87 pension expense was $1,981,667 in total and therefore each company participating in the plan paid its pro-rata share of the $2,000,000 as shown in the table.

Person Responsible: Laurence M. Brock **Date:** November 1, 2005